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ADJUSTMENT OF LABOR'S DEMANDS DURING FEDERAL CONTROL OF RAILROAD OPERATION

BY GLENN E. PLUMB

LEGAL STATUS OF RAILROAD PROPERTIES

Railroads are public highways, so declared by the various state constitutions, and so held by the Supreme Court from the beginning of railroad history. They are in the nature of things public highways to be used in a particular manner, but highways devoted exclusively to public use, and over which the public have an indefeasible right of transportation. Under the terms and conditions prescribed by law the operation of railroads as public highways is purely a function of government, the exercise of which has been delegated by the various states to the corporations which they have created for that particular exclusive purpose. All of the property which railroad corporations have been permitted to acquire under the terms of their charters is held subject to the perpetual right of passage retained by the public. Public highways are matters purely of public concern, in which no private property interest can exist, except such interests as have been conferred by legislative enactment. The extent of these private interests must be determined from the terms of the grants under which they have their existence. All interests in public highways, which are not included within the grant which the legislature has made, remain in the public. All of the functions which railroad corporations exercise under their charters are delegated governmental functions.

There are naturally three separate and distinct interests in railroad properties: the interests of labor, the interests of capital, and the interests which the public have retained in this property which has been acquired solely for public use. Labor's interests are inherent, not based on grant or legislative enactment, save for those rights which are protected by remedial legislation. Labor has the right to demand, and the public interests require that it shall obtain, sufficient remuneration to attract men of the required intelligence to offer their employment in the service, and to provide

sufficient inducement to retain these men in the public service. The interests of capital are protected by contract and based on legislative and charter grants. Under such grants capital is entitled to receive a fair return for its use in the public service, and this fair return must be so construed as to afford sufficient inducement to attract capital to the public service and to retain it permanently in that service. The public interest requires that the tax levied in the shape of tolls and charges shall produce an amount sufficient to satisfy the interest of labor and provide the agreed returns on capital, in addition to protecting the integrity of the investment through proper maintenance and renewal charges. The public interest is entitled to protection against the imposition of tolls and charges in excess of the rates necessary to produce an income which shall satisfy the requirements of labor and of capital.

EXTENT OF LABOR'S INTERESTS IN RAILROAD PROPERTIES

I wish to outline, briefly, the extent of labor's interests in railroad properties: *first*, as to the number of citizens directly affected by such interests; and *second*, the amount and importance of the financial interests involved.

There are approximately 1,700,000 men employed in railroad operation within the United States. Allowing three dependents to each worker, 6,800,000 are directly dependent upon railroad operation for their livelihood. This is about one-sixteenth of the population of the continental United States. This proportion of the total population is therefore more directly interested in the solution of railway problems than the rest of the entire citizenry of the country.

The public paid in wages and salary to the 1,700,000 men who operated these railways, in the year 1916, the sum of \$1,500,000,000. For the use of capital in the same year there was paid, in dividends and interest, the sum of \$827,000,000. The owners of the money which was devoted to railway service of the public have capitalized their investment at \$21,000,000,000. If the return paid to labor were capitalized on the same basis, it would represent a labor investment of upwards of \$37,000,000,000. This actual labor investment is nearly double the amount for which the actual money investment has been capitalized. The capitalization of the money investment, however, does not actually represent the number of

dollars employed in the public service, but represents merely the par value of the securities which have been issued against an actual investment of dollars which is very much less in amount than that which the face or par value of the securities purports to represent.

The number of dollars actually employed in the service of the public in railroad operation, and entitled by reason of that service to receive a return in interest or dividends, corresponds, in principle, to the number of men employed in this service, and entitled to receive compensation in the form of wages or salaries. It is just as much a fraud against the public to pad the dollar payroll in such a manner as to require an increased exercise of the state's delegated power of taxation, in order to pay a return on such a padded capital payroll, as it would be to pad the wage payroll.

In the present situation there is no padding of payrolls for the advantage of labor. No fictitious names appear on such payrolls. No amounts are paid out for services which are not actually rendered. The number of men employed, the hours, days, or months of their service, are definitely ascertained. The amounts which they receive for the services actually rendered are known with great certainty. The public are not defrauded by the payment of wages for fictitious employes who render no service.

It is not so with capital. We do not know the number of dollars actually invested and which at this time are employed in the service of the public. We only know that the capital payroll purports to represent \$21,000,000,000, which are alleged to be serving the public, but it is admitted that \$4,000,000,000 of this amount is duplicate capitalization, and it is also admitted that the remaining \$17,000,000,000 of securities do not in all cases represent the actual number of dollars devoted to the public service,—as in the Alton case. Its capitalization is \$121,000,000, yet Mr. Harriman admitted, when on the stand before the Interstate Commerce Commission, that \$60,000,000 of these securities outstanding did not represent a single dollar of property or investment. The most conservative defender of railroad securities will not attempt to defend the Alton capitalization, and it is severely condemned by railroad financiers themselves, but it is so condemned only because the facts in the case have become established. The record is known, and while not all railroads have practiced the same frauds, to the same extent, few railroads are free from this taint in their financiering;

and many railroads equal, or exceed, in the extent of the frauds which they have perpetrated, the known facts in the Alton case.

Labor is capital. The engineer who commands and is paid a wage of \$1,200 per year performs a service exactly equivalent in importance to the public as does the investment of \$20,000 for which the public pays a return of 6 per cent per year. The capital investment and the labor investment are identical in worth and importance. The one is entitled to as much protection as the other. Neither is entitled to any advantage or privilege denied to the other, but so long as a capital investment of \$20,000 is permitted to masquerade as an investment of twice that amount, and to receive for its services a double wage, by means of fictitious bookkeeping, capital does receive an advantage which is denied to labor, and that advantage must represent a corresponding loss or burden which either labor, the public, or both, must bear.

Heretofore when labor has approached capital as its employer and asked for a betterment of working conditions, or an increase in the compensation to be paid for its services, capital has always replied:

The rates which we may charge the public for the use of our property are fixed by law. We cannot increase our returns without legislative enactment. The net returns now secured under existing rates are not sufficient to give us a reasonable return upon the amount for which we have capitalized our investment, therefore, we cannot increase your wages, unless you can procure for us a corresponding increase in rates.

These rates, and any increase thereof, must be borne directly by the public, so that the labor organizations, in seeking to obtain better wage conditions, have always been placed in direct opposition to the public interests. It has always been made to appear that the laborer, through his organization, was seeking to obtain a benefit for himself at the expense of the public.

Whenever capital has consented to increase the wages of labor it has immediately sought to secure an increase in rates, upon the ground that more money was needed to meet the increased operating expenses, and that as the net returns were not sufficient to pay reasonable dividends on the number of dollars then expressed as being in the public service, the increased cost of wages must be met by an increased rate of charges.

The carriers have been strenuously contending that all of the

profits which they can make under rates fixed by law are the exclusive property of the owners of the money invested in the enterprise; that the amount of such net profits represents the value of their properties; and that they are entitled to capitalize the value so determined. They further contend that they are entitled to establish such rates as will protect the value so determined.

If this be true, then the greater their net receipts, the greater the value of the interest which they claim in such properties. Any value which accrues to them by reason of a rate increase would be a property right, protected by the Constitution, and could not be diminished by an increase in wages made by direction of the government, without depriving them of the value of their so-called property right. The evil of the situation lies in the uncertainty as to the extent of the private interest which belongs to the owners of the dollars invested in such properties. If that interest were ascertained and made definite, the evils of the old system of railroad operation would be very greatly corrected. There must be a determination of the actual number of dollars invested in such properties. We must know how many dollars are employed in the public service, and what reasonable return they are entitled to receive. When these facts are judicially ascertained, then we can limit the taxing power so that no more than the necessary amounts of money shall be provided. If more is provided we can require that the excess, which the public has paid, shall be devoted to the public use in such manner as not to increase private interests. If such excess be expended in betterments or additions to property, then the value of these betterments or additions is a part of the value of the public interest. It is not to be added to the value of the private interest. If it be just, such excess earnings can be applied to increase wages without increasing rates or diminishing rates without lessening wages.

WHAT ARE THE EXACT RIGHTS OF CAPITAL IN RAILROAD PROPERTIES?

The railroad labor organizations have determined that in the interest of labor the exact rights of capital in railroad properties must be definitely ascertained. These organizations believe that this is also in the interest of the public, and this must be done whether the railroads are to be operated under governmental con-

trol or are to be returned to private operation, subject to governmental regulation.

The government has now reassumed to itself its proper function of operating these public highways. However, it is obligated to pay to the corporations, to whom the government had delegated the exercise of these functions, what is entitled "just compensation." This "just compensation" has been arbitrarily assumed to be an annual amount, equivalent, as nearly as may be, to the average annual net operating revenues for the years 1915, 1916 and 1917. No attempt has been made to ascertain whether or not this so-called "just compensation" is sufficient to meet the legal demands of capital, or is more than enough to pay compensation for the amount of money actually devoted to the public service. If it is not enough we should know it. If it is more than enough the public are being unjustly taxed, and if the public are being unjustly taxed for the benefit of capital, it becomes correspondingly more difficult to increase this tax to meet the just demands of labor. The necessity for a final determination of the amount of money required to meet the lawful demands of capital is greater, if possible, under government control than it would be under private operation.

Labor recognizes that an existing property right cannot be taken away by new legislation, without making just compensation for the value of the right. All existing rights must be determined under existing laws. We are firmly convinced that the laws, as they are now written in the constitutions and statutes of the various states, as construed by their supreme courts, and the Supreme Court of the United States, do afford an ample and sufficient basis for the determination of such rights. These laws do provide: (1) that railroads are public highways; (2) that the operation of a public highway is a governmental function; (3) that railroad corporations are agencies created for the exercise of these governmental functions; (4) that no private property interest can exist in a public highway, except that which is based upon a legislative grant; and (5) that corporations cannot acquire or assert against the public any property interest, right or privilege, except those which have been granted by their charters, or the laws under which they operate.

If these premises are to be accepted, it necessarily follows that the extent of the property interests which corporations may enjoy,

in the public highways which they operate, must be determined from a study of the charter provisions under which they have acquired these properties, together with the limitations imposed by the laws of the jurisdiction within which they operate.

RIGHTS OF CAPITAL MUST BE DETERMINED BY CHARTERS AND LAWS

The limitations of this article preclude anything more than an outline of the theory above stated. The privilege of issuing railroad securities is a corporate franchise. The limitations imposed upon this privilege are expressed in the grant, or the laws under which the grant was made. Corporations, being creatures of statute, do not receive their franchises from the common law, but the common law has imposed many limitations upon the powers of corporations—limitations which the experience of mankind, under the English system of government, has found necessary in order to preserve public rights against the encroachment of granted privileges. Among these limitations so imposed by the common law is the principle that unless directly authorized to do so by its charter, the corporation may not issue stocks or bonds of a par value in excess of the amount of money actually paid into the corporation, as a guaranty for the performance of its franchises. This is perhaps best exemplified by the decision of the Supreme Court of Alabama in *Commercial Fire Insurance Company v. Board*, 99 Ala., 1 at page 4, where the Court said:

Capital stock is the sum fixed by the corporate charter as the amount paid in, or to be paid in, by the stockholders, for the prosecution of the business of the corporation, and for the benefit of corporate creditors. The capital stock is to be clearly distinguished from the amount of property possessed by the corporation. . . . At common law the capital stock does not vary, but remains fixed, although the actual property of the corporation may fluctuate widely in value, and may be diminished by losses, or increased by gains. . . . When we speak of capital stock of a corporation we are understood to refer to the sum subscribed in its organization. When we speak of stock we mean the certificate issued by the corporation to the shareholders, which certificates, like titles to property, furnish the evidence of ownership of the shares of stock. Capital stock is the aggregate of money or other valuable things contributed or paid into the common treasury, as condition of the exercise of corporate functions, and a security for their faithful and prudent exercise. It is the property of the corporation, charged with a trust, it is true; but nevertheless, in its possession and control.

This common law requirement, that the amount invested in the exercise of the corporate franchise should be the exact equivalent of

the par value of the corporate securities issued, was, in the early years of railroad history, modified to some extent by the different state legislatures. The abuses resulting from the legislative privileges so granted became so scandalous that, beginning with Illinois in 1870, the people of the various states, through their constitutions, restored this old common law limitation to its former vigor and effect and at the same time deprived the legislature of any power in the future to in any way abate this requirement.

Railroad history began about the year 1830. This common law limitation upon the privilege of issuing stocks and bonds was then fully recognized. Railroad builders recognizing this limitation and faced with the difficulty of financing their promotions if held to this strict letter of the law, began to include in the charters which at that time were directly granted by legislative enactment, provisions authorizing them to issue their stocks and bonds for a consideration less than par. In many instances these charters specifically provided that such securities might be issued for any price the directors saw fit to accept and that, when so issued, they should have the same validity as though issued at par. The legislative authority so conferred upon these corporations was in abrogation of the common law and undoubtedly made legal the issuance of what would otherwise have been fictitious securities.

At the close of the Civil War, although we were then in the early stages of railroad development, there had been many scandalous emissions of watered securities which called forth a tremendous popular protest. At that time the railroads claimed that they had a right to earn a reasonable return upon the par value of the securities so issued. Many of the states faced this problem in the constitutional conventions called to frame new constitutions. Illinois, in 1870, adopted its present constitution in which it embodied the following provision:

No railroad corporation shall issue its stock or bonds except for money, labor, or property actually received and applied to the purpose for which such corporation was created. Any stock dividend, or other fictitious increase of capital stock or indebtedness shall be void.

The right asserted by the railroads at that time was that they had conferred upon them by their charters the right or privilege of charging such toll as would afford them a reasonable return upon the

par value of the securities which they had issued. In the constitutional debates, this assertion of right was met by the declaration that in order to prevent unjust taxation the people would provide in their constitution that the issuance of securities must exactly correspond with the actual investment made, in order that the returns received by the holders of such securities might be accurately known to the public and in order that the power of regulation might be intelligently exercised. At that time no railroad company had ever asserted that it was entitled to receive a return upon the value of its property.

In the Illinois constitutional debates, Judge Elliott Anthony in discussing the proposed adoption of the provision limiting the issuance of securities, said:

I wish to explain for a moment where the evils come into the community by the increase of the capital stock. The managers care nothing about the public, but in order to keep up the stock, they raise the rates of freight in order to declare dividends upon the watered stock. It is a fact well known that the moment these managers, who care nothing for the public, get control of the railroads and its earnings, they use them for the purpose of making money and stock manipulating. Rates are increased largely, by which they seek to make their watered stock pay dividends and keep it up in the market, and the injury to the public is very great.

Shortly thereafter Pennsylvania incorporated a like provision in its new constitution, and Mr. Howard, in addressing the convention in the debates on this provision, said:

But hereafter it should be known that the stock will not be allowed to be increased without limit. We should know that the stock is to be used for a legitimate and a valuable purpose; that it is to build railroads; that the issue of stock is necessary to build them, and that it is not the intention to water the stock or increase it unnecessarily. After this stock is increased it must be made to earn dividends; it must make its proper interest, and the people of the Commonwealth must be taxed in the price of transportation for the purpose of raising money to pay dividends on that stock, and, therefore, it is the right of the people to know that those issues of stock are necessary and that the proceeds are to be used for legitimate and proper improvements.

In the Kentucky constitutional debates, in discussing a like provision, Mr. Clardy said:

Now, it is a fact that a great many corporations in this State and elsewhere would show a much larger dividend, and the people would be able to see to what extent they had been imposed upon by these corporations, if it was not for the fact that the stock represents something which really does not exist, and this we seek to avoid in this fifth section.

Space will not permit me to go further into this phase of the historical development of constitutional provisions. Enough has been shown to demonstrate that the people, in the adoption of these provisions, clearly intended to compel railroad companies to make the par value of the securities issued by them coincide with the amount of investment made by the subscribers to such securities, and that the corporation's right or power to tax the people by the imposition of tolls and charges should be strictly limited to such exercise of that power of delegated taxation as would procure a reasonable return upon the investment which the subscribers to such securities had made in the corporation.

This constitutional provision has been embodied in nearly every new state constitution adopted since 1870, with the exception of the states of New York and Ohio, and in Ohio similar provisions are embodied in that portion of the constitution authorizing the creation of the state utilities commission.

In many other states in which no new constitutions have since been adopted, like limitations have been established by legislative enactment. The effect of this constitutional provision was to restore to full force and vigor the former common law limitation imposed upon all corporations, and it had the further effect, in the various states which had adopted this provision, of depriving the legislature of any power thereafter to remove the limitation so imposed. The Supreme Court of Illinois, in the case of *People v. Union Consolidated Elevated Railway Co.*, 263 Ill., 32, held that by this provision of the constitution:

The State retains the right to regulate rates charged by railroads, but it has not the power to fix tolls or charges at so low a rate as to destroy the investment or deprive the Company of its right to a reasonable return on the investment.

This constitutional declaration that issues of securities of a par value in excess of the investment actually made and applied to corporate purposes should be void now prevails in some 26 states. The common law prevails in all states except Louisiana and some code states, but in Louisiana the constitution prescribes the same limitation and in many of the code states like provisions have been supplied by the legislature. In many states that have not adopted new constitutions since 1870 this limitation has been imposed by statute. The purpose of this limitation, as construed by the Supreme Court of Illinois, was to preserve in the state a right to regulate the use of

these highways, provided that in such regulation the state did not deprive the carrier of its investment or a fair return upon the investment.

The full extent of the private interest which the legislature has granted to carriers in public highways, under such a limitation, is measured by its investment devoted to the public service, and any regulation of the use of the highways which preserves to the carrier the integrity of its investment and a fair return upon that investment secures to the corporation all of the rights which are guaranteed to it by the constitution.

LABOR'S DEMANDS CAN BEST BE ADJUSTED AFTER CAPITAL'S
RIGHTS ARE DETERMINED

The determination of the extent and value of the rights which have been granted to railroad corporations is a judicial question. The federal government needs only to provide a forum for the determination of that question, before whom all corporate interests may be presented. Such a determination will forever settle the extent of the private rights in our great national highways. Upon such a determination the demands of labor can be fairly adjusted without the antagonism of the owners of capital, and without undue popular disfavor. Organized labor is earnestly seeking to procure such a determination. We believe that the public interest requires that this should be done.

If this can be brought about a sound basis will have been laid for future regulation and even for governmental acquisition, if in the course of time the people should demand it. When these rights are so ascertained, the speculative element in railroad securities will have been eliminated. Investments made therein by widows, orphans, insurance companies and savings banks will be as safe as though they rested upon governmental securities. Until this is done labor will be restless, capital will shrink from a venture that does not offer adequate security, and the sovereign powers of governmental regulation must be clouded with doubt and uncertainty, and forever hindered by litigation.